

STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION

At a session of the Public Service  
Commission held in the City of  
Albany on September 3, 2008

COMMISSIONERS PRESENT:

Garry A. Brown, Chairman  
Patricia L. Acampora  
Maureen F. Harris, concurring  
Robert E. Curry, Jr.

CASE 07-M-0906 - Joint Petition of Iberdrola, S.A., Energy East Corporation, RGS Energy Group, Inc., Green Acquisition Capital, Inc., New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation for Approval of the Acquisition of Energy East Corporation by Iberdrola, S.A.

ABBREVIATED ORDER AUTHORIZING ACQUISITION  
SUBJECT TO CONDITIONS

(Issued and effective September 9, 2008)

We initiated this case to consider a joint petition filed on August 1, 2007 under Public Service Law (PSL) §70 by petitioners Iberdrola, S.A. (Iberdrola), New York State Electric & Gas Corporation (NYSEG), Rochester Gas and Electric Corporation (RG&E), Energy East Corporation (Energy East), RGS Energy Group, Inc., and Green Acquisition Capital, Inc. in which they seek approval of Iberdrola's acquisition of Energy East.<sup>1</sup> This abbreviated order states our conclusions and, in the accompanying appendices, sets forth the conditions that are part

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<sup>1</sup> NYSEG and RG&E are both wholly-owned subsidiaries of RGS, which in turn is a wholly-owned subsidiary of Energy East. Green Acquisition Capital is a wholly-owned subsidiary of Iberdrola formed for the purpose of this proposed acquisition. Following the transaction, Green Acquisition Capital will be merged into Energy East.

of our decision to approve the proposed transaction. A more comprehensive order will be issued subsequently, stating in more detail the reasons for our conclusions and the conditions we are now adopting.<sup>2</sup>

Public statement hearings were held on February 19 through 22, 2008, in Carmel, Binghamton, Ithaca, Lancaster, Rochester, and Plattsburgh. Evidentiary hearings began on March 17, 2008, and continued through March 20, 2008. Parties submitted initial post-hearing briefs on April 11, 2008, and reply briefs on April 25, 2008. The administrative law judge's Recommended Decision (RD) was issued June 16, 2008. Parties filed briefs on exceptions to the RD on June 26, 2008, and replies to exceptions on July 3, 2008.

At public deliberative sessions on August 20, August 27, and September 3, 2008, we considered the entire record including the evidence, pleadings, and the many comments provided by members of the public, and reached the following conclusions.

Under the PSL §70 "public interest" criterion applicable to this proposed transaction, petitioners must show that the transaction would provide ratepayers a positive net benefit. Here, we have weighed the expected benefits from the transaction against related risks and detriments remaining after applying reasonable mitigation measures. We conclude that, with the provision of the positive benefit adjustments (PBAs) and the conditions ordered here, Iberdrola's acquisition of the Energy East companies will provide ratepayers sufficient positive net benefits to warrant its approval under PSL §70.

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<sup>2</sup> The time allowed for petitions for rehearing under 16 NYCRR 3.7 will commence at the issuance date of the comprehensive order.

ASSERTED BENEFITS OF THE TRANSACTION

On exceptions to the RD, petitioners and other parties assert that, contrary to the RD's findings, there are benefits to the proposed transaction that should be considered in our decision. They cite the following as the most significant benefits:

- Iberdrola's commitment to support investment of \$100 million in renewable generating resources;
- petitioners' offer to divest fossil fuel generating plants and to share up to 90% of the above-book proceeds with ratepayers;
- Iberdrola's credit rating and financial strength;
- Iberdrola's sharing of best practices and global utility expertise; and
- petitioners' proposal to provide \$201.6 million of PBAs.

We address these, in turn, below.

Renewables Commitment

We conclude that Iberdrola's ongoing participation in the New York State wind industry offers some benefit in advancing our renewable energy goals. Therefore, consistent with our existing policy of using wind development as an important means of achieving those goals, we do not condition our approval here on a prohibition against Iberdrola's development or ownership of wind facilities in the State.

Indeed, to strengthen Iberdrola's commitment to invest in renewables in New York, we will condition our approval of the transaction upon a requirement that Iberdrola commit to make

wind-related capital investments in New York worth \$200 million.<sup>3</sup> This requirement will be subject to the same contingency Iberdrola placed on its original \$100 million commitment, namely, that there be "no material adverse change to the existing fundamental economics of wind generation development in New York State."<sup>4</sup> However, this qualification does not extend to the economics of any individual wind project, such as land rights acquisition, turbine rights acquisition, financing, construction, interconnection, or operation and maintenance.<sup>5</sup>

This capital investment requirement applies to incremental investment in construction of new wind projects, as distinguished from investment in or acquisition of existing wind resources or sums already spent on projects underway. This requirement may be satisfied by new investments in wind projects within New York State that are made during the initial two years following the acquisition's closing date. We are willing to consider, however, upon a petition from Iberdrola, a modest extension of the two-year period.

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<sup>3</sup> We note an ambiguity in both petitioners' March 14, 2008 "Partial Acceptance" document (Exhibit 50) and their Brief Opposing Exceptions. In those documents, Iberdrola commits "to support" an investment of \$100 million in renewable generation. Given Iberdrola's 80% ownership interest in Iberdrola Renewables and its capacity to create other means to make such an investment, we resolve this ambiguity by requiring Iberdrola to make, rather than merely support, such an investment, and we increase the required investment from \$100 million to \$200 million.

<sup>4</sup> Petitioners' Brief Opposing Exceptions, p. 6, quoting from Partial Acceptance, Exhibit 50, p. 2. According to petitioners' qualification, this condition would relieve Iberdrola of its commitment should the federal production tax credit or our renewable portfolio standard subsidies be eliminated or reduced, or should there be material changes in the market price for power in the market maintained by the New York Independent System Operator (NYISO). Petitioners' Brief Opposing Exceptions, p. 6.

<sup>5</sup> Id., pp. 6-7.

Economic Development Fund

Given the uncertainties of bringing wind projects to fruition, it is reasonable to ensure that, notwithstanding the qualification on petitioners' investment commitment, some value of a commitment to the State's economic vitality is realized. Therefore, we will require that, if, for whatever reason, Iberdrola is unable to reach the total of a \$200 million investment in the development of wind generation in the State in the initial two years following the acquisition's closing (subject to extension by the Commission, as noted above), it must contribute up to \$25 million toward economic development projects in the NYSEG and RG&E service territories.<sup>6</sup> Such economic development funding will come from shareholders, not ratepayers, and will be incremental to any ratepayer-funded economic development programs included in the Energy East companies' current rates. Depending on the extent of the shortfall in wind investment, Iberdrola will be required to set aside prorated amounts in an economic development fund equal to 25% of the difference between the \$200 million and the amount actually expended, which, for purposes of this calculation only, shall be assumed to be not less than \$100 million.

Thus, if for whatever reason, Iberdrola invests under \$100 million in new wind projects, the amount of economic development funds set aside would be \$25 million. If it invests \$200 million or more, the shareholder contribution to the economic development fund would be zero. For investments between \$100 million and \$200 million, contribution to the economic development fund would be prorated. For example, if Iberdrola achieves an investment of \$150 million in wind

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<sup>6</sup> Therefore, whereas the \$200 million wind development commitment discussed in the preceding section is subject to "material adverse changes to the existing fundamental economics of wind generation development," this economic development commitment has no qualification.

projects, the amount of the economic development fund set aside would be \$12.5 million. Iberdrola is required to file, at the end of the two years following the acquisition's closing, details of the wind investments made and any contributions required to be made to the economic development fund pursuant to this order; and, within 60 days thereafter, work with stakeholders to develop and submit a proposal for Commission approval detailing the application of the economic development fund.

We acknowledge that directing such investment in wind facilities potentially conflicts with our vertical market power policy. As stated below, the vertical market power risks cannot be fully eliminated. However, given that the investment will be consistent with our policy to promote renewables, will likely result in a modest amount of new generation (approximately 100 MW), will be subject to conditions designed to address vertical market power concerns, and will be made part of a package including \$275 million in ratepayer benefits, we conclude that directing such investment is in the public interest in this instance.

#### Fossil Generation Divestiture

RG&E already is committed to divest its fossil-fueled Russell Station, independent of our decision in this proceeding. Petitioners' proposed divestiture of the remaining Energy East fossil assets does represent a benefit here that we have taken into account in our evaluation, and we make such a divestiture commitment a condition of our approval. Moreover, petitioners and their affiliates and subsidiaries are prohibited from owning any fossil-fueled generation within New York State in the future.

We do not consider petitioners' proposal for sharing above-book proceeds from the divestiture of the fossil fuel

generation to be a net benefit of the transaction. We have full authority to determine the disposition of such proceeds; therefore, petitioners' proposal, that ratepayers receive 90% of above-book proceeds and that shareholders retain 10% of such proceeds, does not represent a benefit that would otherwise be unavailable. In any event, we will follow the recommendation put forth in the RD to consider any sharing of above-book proceeds from the sale of fossil assets together with other details of a divestiture plan, such as the auction protocols and a timetable for accomplishing the divestiture, at a later time, after the parties have had an opportunity to collaborate and present such issues more fully for our consideration.

We will direct petitioners to collaborate with all interested parties to develop auction protocols, a timetable for divestiture, and the disposition of above-book proceeds from the sale, including any sharing between ratepayers and shareholders. Within 90 days of the closing of the acquisition approved in this order, the petitioners shall file with the Secretary to the Commission a divestiture plan that is the result of the collaborative process. In the event the parties are unable to agree upon all the details of such plan, the petitioners shall indicate which elements have and have not been agreed to by other parties in the collaborative process and shall justify the petitioners' position as reflected in the filing. Other parties shall thereafter have 20 days in which to comment and to propose and justify alternative plans. We thereafter will issue a decision on the divestiture plan.

#### Creditworthiness and Financial Strength

In considering financial and corporate structure issues, we have concluded that the asserted benefits of Iberdrola's financial strength and managerial expertise are outweighed by the risks of the international holding company

structure. These include problems with reporting transparency, cross-subsidization and other potential affiliate company abuses, complexity interfering with effective regulation, the comparative riskiness of Iberdrola's competitive ventures, and the possibility of harm to Energy East's subsidiaries as a result of the unpredictability and potential financial deterioration associated with Iberdrola's other enterprises. The financial risks in turn pose a threat that the merged companies will have difficulty maintaining appropriate levels of safety, reliability, and customer service performance. The effect of Iberdrola's management expertise is too elusive to be considered a benefit, as petitioners have predicted no synergies or efficiency improvements resulting from the transaction. The risks and detriments will be mitigated by the conditions we are adopting (set forth in the attached Appendices) related to financial structure, corporate governance, regulatory monitoring, and reliability, safety and service quality, but cannot be completely eliminated. Overall, therefore, we regard petitioners' financial profile and corporate structure, post-merger, as a detriment rather than a benefit of the transaction.

Proposed PBAs

Late in the proceeding, petitioners offered PBAs in the amount of \$201.6 million. While this magnitude of PBAs is not insignificant, this amount coupled with the very modest benefits described above would not outweigh the detriments associated with this transaction, to which we now turn.

ASSERTED DETRIMENTS OF THE TRANSACTION

The transaction's asserted detriments identified in the proceeding include:

- financial and corporate concerns, including those relating to goodwill, credit rating, the holding company structure;

- service quality degradation with respect to reliability, safety, and customer service; and
- the creation of vertical market power due to the integration of a transmission and distribution (T&D) company with a company owning generation.

In evaluating these detriments, we have considered various measures intended to mitigate these identified risks. We impose a number of conditions here, but we are cognizant that the conditions we adopt will lessen--but cannot eliminate--the harm or the risk of harm that they address.

#### Financial, Corporate and Service Quality Concerns

As noted above, our analysis of Iberdrola's corporate structure and financial condition as an asserted benefit has led to our conclusion that these are detriments which, in turn, lead to increased risks of service quality degradation. We have already addressed these concerns and the associated mitigating conditions above.<sup>7</sup> We note the fundamental importance of safety, reliability, and customer service owed to NYSEG and RG&E customers. Our conditions are designed to ensure that petitioners maintain high standards and that these key attributes of service are not compromised.

#### Vertical Market Power

There remains the issue of vertical market power, which we analyze here with reference to our Statement of Policy Regarding Vertical Market Power.<sup>8</sup> We conclude that the combined

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<sup>7</sup> In imposing conditions to address service quality concerns, we have included measures that petitioners proposed to address specific concerns raised by the New York Association of Public Power, New York State Rural Electric Cooperative Association, the City of Rochester and the Village of Sherburne.

<sup>8</sup> Cases 96-E-0900, et al., Orange & Rockland Utilities, Inc.'s Plans for Electric Rate Restructuring Pursuant to Opinion 96-12, (issued July 17, 1998), Appendix I.

T&D and wind generating company created through this merger would have an incentive and opportunity to exercise vertical market power. In particular, there are at least three areas in which the T&D entities will have an incentive to exercise vertical market power in a way that benefits their affiliates' generation, to the detriment of consumers. First, NYSEG and RG&E will have an incentive to under-invest in transmission that, if built, could increase imports of low-cost power into upstate New York. Second, they will have an incentive to over-invest in transmission to help relieve any deliverability problems for the energy output of their affiliated generation and to under-invest in transmission that, if built, would help relieve energy deliverability problems of competing generators. Third, they will have an incentive to use their role in the generator interconnection process to delay rival generators and/or raise the costs such generators incur to interconnect to the transmission system.

Notwithstanding these incentives, we note that the magnitude of the vertical market power problems associated with this acquisition are less severe than those associated with the National Grid acquisition of KeySpan last year, a case in which vertical market power problems prompted us to require the divestiture of the Ravenswood Generating Station in New York City as a condition of the acquisition.<sup>9</sup> For example, New York City is more of a clear-cut, higher-priced load pocket than is upstate New York and the Ravenswood generating station is much larger than Iberdrola's expected upstate generation.

Under the Vertical Market Power Policy Statement, we can allow ownership of generation by a T&D company if there is a demonstration of "substantial ratepayer benefits," together with measures to mitigate the vertical market power risk, which

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<sup>9</sup> Case 06-M-0878, National Grid and KeySpan Corp., Order Authorizing Acquisition (issued September 17, 2008).

justify the combined vertical ownership. In this case, by conditioning our approval on divestiture of all fossil-fueled generation, we will eliminate the vertical market power concerns with respect to that type of generation. While we will allow NYSEG and RG&E to continue to retain their hydroelectric generating facilities in rate base, we will continue to exercise ratemaking oversight of them.

With respect to our decision to allow Iberdrola, through affiliates separate from NYSEG and RG&E, to construct and operate wind generation, we are imposing conditions on the transaction which will mitigate (but not eliminate) vertical market power risks. We rely, as well, on substantial ratepayer benefits--PBAs in the amount of \$275 million--as described below.

Our decision does not change our policy on vertical market power. Any future PSL §70 filing that seeks our approval of the ownership of generation by a T&D company affiliate will need to demonstrate either that vertical market power cannot be exercised or that substantial ratepayer benefits, together with mitigation measures, overcome the presumption that would otherwise bar a T&D company from owning generation.

POSITIVE BENEFIT ADJUSTMENTS AND RATEMAKING PBAs

Our analyses of the issues of wind development, vertical market power, and financial and corporate structure as presented in this case lead to the conclusion that the proposed transaction's net benefits fail to satisfy the PSL §70 public interest standard unless they include a monetized benefit to customers in the form of PBAs. Based on our review of the record in this case, we find the \$201.6 million offered by petitioners to be inadequate and the \$646.4 million advocated by Staff to be overstated. We have determined that the amount of PBAs needed to meet the requirements of both PSL §70 and the

Vertical Market Power Policy Statement while also maintaining just and reasonable rates is \$275 million.

The PBAs should be recorded on the books of NYSEG and RG&E effective as of the acquisition's closing date, allocated among the companies' four departments (at NYSEG and RG&E respectively, electric and gas) in proportion to the departments' respective delivery revenues for calendar year 2007. To promote rate stability and preserve the scope of our discretion when applying the PBAs for the benefit of ratepayers, we will direct petitioners to defer the PBAs for disposition in NYSEG's and RG&E's future rate proceedings. Pending such disposition, the PBAs will accrue interest at the respective companies' allowed pre-tax rates of return.

#### Rate Filings and Earnings Sharing

The \$275 million PBA amount we are adopting is not intended to reflect synergy and efficiency savings attributable to the transaction. To provide ratepayers a share of any such savings, an additional condition of our approval is that NYSEG and RG&E file electric and gas rate applications during a "target period" which is the 30 days immediately following the first anniversary of the acquisition's closing date, or become subject to the earnings sharing mechanism described below. The scope and quality of evidence filed in support of any such application must conform with our rules and policies applicable to an application for a major rate change. Notwithstanding the target period, either company may file a general rate application at any time upon a showing that its financial performance otherwise would fall to levels that would jeopardize its ability to provide safe and reliable service.

As an alternative means of capturing a share of synergy and efficiency savings for ratepayers, should either company elect to forgo an electric or gas rate filing as

described above during the target period, that company must implement an earnings sharing mechanism (ESM) for each department (electric or gas) that is not the subject of a rate filing. Any such ESM will take effect no later than the beginning of the first calendar month after the target period.

Under this ESM, shareholders will retain 20% of any earnings in excess of the cost of equity, which we have updated to 10.1%, and the remaining 80% will be preserved for ratepayers. Earnings under this ESM will be calculated on the basis of financial results for delivery operations commencing at the beginning of the first calendar month after the target period. The 10.1% cost of equity will apply to NYSEG's electric operations and supersede any pre-existing sharing thresholds in NYSEG's gas rate plan and RG&E's electric and gas rate plans, but will not affect any ESMs applicable to commodity earnings associated with NYSEG's or RG&E's fixed price options. If an ESM is required for NYSEG's electric department, which currently has none, the company will file, within 30 days after the expiration of the target period, an ESM proposal for Commission approval, designed to be effective as of the beginning of the first calendar month following the target period.

To ensure that the ratepayers' share of excess earnings is not understated, the earnings calculation for purposes of the ESM will use an equity ratio based on Iberdrola's consolidated capital structure or a 45% equity ratio, whichever is less. However, we will consider using a stand-alone equity ratio greater than 45% upon a showing that the rating agencies consider the utility operating subsidiary in question to be adequately insulated from the risks of Iberdrola's other operations.

To ensure that the ratemaking process accounts for savings and costs related to operational changes resulting from the transaction, NYSEG and RG&E each must provide, in prefiled

testimony as part of its next general rate case filings (whether within or outside the target period), all studies, analyses and related workpapers prepared by Iberdrola, its subsidiaries, affiliates, or agents that identify or quantify the costs and savings related to merger synergies, efficiency gains, and the adoption of utility best practices that in any way affect the management, operation and underlying costs of NYSEG's and RG&E's utility business. If a rate filing is made, any earnings sharing mechanisms in force at the time of the filing will remain in place until disposition of the filing.

The Commission orders:

1. The petition pursuant to Public Service Law §70 of Iberdrola, S.A., Energy East Corporation, RGS Energy Group, Inc., Green Acquisition Capital, Inc., New York State Electric & Gas Corporation, and Rochester Gas and Electric Corporation for approval of the acquisition of Energy East Corporation by Iberdrola, S.A. is granted and the transaction therein is authorized, subject to all the terms and conditions set forth in this order and in the appendices hereto, which are an integral part of this order.

2. Iberdrola, S.A. and Energy East Corporation must submit a written statement of complete and unconditional acceptance of this order and its terms and conditions, signed and acknowledged by duly authorized officers, on behalf of themselves and their New York subsidiaries, at the earlier of 4:45 p.m. EST on September 15, 2008 or before any closing of the proposed acquisition. These statements must be filed with the Secretary of the Commission and served contemporaneously on all active parties in this proceeding. In the absence of such acceptance, our approval of the proposed acquisition is rescinded.

3. The Secretary to the Commission shall have discretion to modify the deadlines for filings required under this order, except for (a) the rate filings during the target period as discussed herein and (b) any filings relating to the investments in wind generation required under this order.

4. This proceeding is continued.

By the Commission,

(SIGNED)

JACLYN A. BRILLING  
Secretary

APPENDIX 1

FINANCIAL AND CORPORATE PROTECTION CONDITIONS

1. Goodwill and Acquisition Cost Conditions

(a) No goodwill or transaction costs associated with this acquisition may be reflected on the books maintained by New York State Electric & Gas Corporation (NYSEG), Rochester Gas and Electric Corporation (RG&E), RGS Energy Group, Inc. (RGS), or Energy East Corporation (Energy East) after the closing of the acquisition of Energy East by Iberdrola, S.A. (Iberdrola).

(b) Goodwill and transaction costs must be excluded from rate base, expenses, and capitalization in the determination of NYSEG's and RG&E's rates and earned returns for New York State regulatory reporting purposes.

(c) If at any time after the closing of this acquisition any analysis determines that goodwill on Iberdrola's books from this acquisition, or goodwill already on the books of Energy East or RGS from prior transactions, is impaired to any extent, Petitioners must submit that analysis to the Commission within five business days after the determination has been made.

2. Credit Quality and Dividend Restriction Conditions

(a) Copies of all presentations made to credit rating agencies by Iberdrola or any of its affiliates that relate to NYSEG, RG&E, RGS, or Energy East, together with supporting materials (workpapers, assumptions, and underlying calculations), must be provided, within ten business days of the presentation, to Department of Public Service Staff on a continuing basis.

(b) Iberdrola, Energy East, NYSEG, and RG&E must register with major nationally and internationally recognized bond rating agencies, such as Standard & Poor's, Moody's Investor Service, and Fitch Ratings, and intend to maintain at least an investment

grade credit rating. As long as each company maintains its investment grade rating, and subject to the other conditions of this order, NYSEG and RG&E, respectively, are permitted to pay dividends in any year up to an amount equal to the sum of: (i) income available for common dividends generated in that year; (ii) the cumulative amount of retained earnings accrued in prior years, starting with the closing date of this acquisition; and (iii) that portion of paid-in capital that was recorded on the books of NYSEG or RG&E, respectively, as unappropriated retained earnings, unappropriated undistributed earnings, and accumulated other comprehensive income immediately prior to the closing date of this acquisition, to the extent that those earnings have not already been paid out as dividends in years following the closing date of this acquisition.

(c) To the extent that NYSEG or RG&E desires, for the purposes of this provision, to exclude from the calculation of "income available for common dividends" non-cash charges to income resulting from accounting changes or charges to income resulting from significant, unanticipated events, NYSEG or RG&E, respectively, must first notify the Commission of its intent to do so and provide an explanation for that action. NYSEG or RG&E, respectively, may exclude the items identified in the notification if the Commission or its designee has not, within 30 days from the date of its receipt of notification, notified the company that additional review is necessary. Under no circumstances may the balance of retained earnings become negative as a result of a dividend payment.

(d) Unless specifically authorized by the Commission, NYSEG and RG&E each is prohibited from paying common dividends if: (i) the bond rating on the least secure form of debt issued by it falls to the lowest investment grade rating and there is a

negative watch or review downgrade notice for the company as determined by any nationally recognized rating agency or, alternatively, if the bond rating for the company in question immediately falls to non-investment grade without such a notice; or (ii) the bond rating on the least secure form of debt issued by Iberdrola or Energy East falls to the lowest investment grade rating and there is a negative watch or review downgrade notice for Iberdrola or Energy East as determined by any nationally recognized rating agency or, alternatively, if the bond rating for Iberdrola or Energy East immediately falls to non-investment grade without such a notice.

(e) If a ratings event described in clause (i) of subparagraph (d) above occurs with respect to NYSEG or RG&E, the company affected by that ratings event may not transfer, lease, or lend any moneys, assets, rights, or other items of value to any affiliate without first obtaining Commission approval. If a ratings event described in clause (ii) of subparagraph (d) occurs, neither NYSEG nor RG&E may transfer, lease, or lend any moneys, assets, rights, or other items of value to any affiliate without first obtaining Commission approval. These provisions exclude payments for goods, services, and assets related to reasonable commitments made 180 days or more before the triggering event, routine transactions required in the regular course of business pursuant to contracts or other arrangements in existence 180 days or more before the triggering event, corporate taxes, and payments, if not accelerated, of principal or interest on loans.

(f) If a ratings event described in subparagraph (d) above occurs, Iberdrola, Energy East, NYSEG, and RG&E must file a plan with the Secretary to the Commission within 60 days explaining the actions that are planned to address and rectify the

situation. The dividend payment and value transfer provisions in subparagraph (d) above end when the relevant credit rating is restored, the negative watch or review notice is removed with no negative action taken, or the Commission or its designee specifically approves the payment of dividends or transfer of items of value.

### 3. Money Pooling Conditions

(a) NYSEG and RG&E may participate in a money pool only if all other participants, with the exception of Iberdrola, Energy East, and RGS, are regulated utilities operating within the United States, in which case NYSEG or RG&E may participate as either a borrower or a lender. Iberdrola, Energy East, and RGS may participate only as lenders in money pools involving NYSEG or RG&E. Neither NYSEG nor RG&E may participate in any money pool in which any participant directly or indirectly loans or transfers funds to RGS, Energy East, or Iberdrola.

(b) Neither Iberdrola, Energy East, nor any of their affiliates may have any cross default provision at closing of the approved acquisition that affects NYSEG or RG&E in any manner. Neither Iberdrola, Energy East, nor any of their affiliates may enter into any cross default provision in the future that affects NYSEG or RG&E in any manner. To the extent that any cross default provision that might affect NYSEG or RG&E already exists, Iberdrola and Energy East must use their best efforts to eliminate that provision within six months of closing. If any cross default provision remains in effect at the end of that period, Iberdrola must obtain indemnification from an investment grade entity, at a cost not borne by ratepayers, that fully protects NYSEG and RG&E from the effects of any cross default provision.

#### 4. Special Class of Preferred Stock Conditions

(a) NYSEG and RG&E each must modify its corporate by-laws as necessary to establish a voting right in order to prevent a bankruptcy, liquidation, receivership, or similar proceedings ("bankruptcy") of NYSEG or RG&E, respectively, from being caused by a bankruptcy of Iberdrola, Energy East, or any other affiliate.

(b) Within six weeks after closing of this acquisition, NYSEG and RG&E each must file a petition with the Commission seeking authority to establish a class of preferred stock having one share, subordinate to any existing preferred stock, and to issue that share of stock to a party, to be proposed by NYSEG or RG&E, respectively, and approved by the Commission, who shall protect the interests of New York and be independent of the parent company and its subsidiaries. Each share of stock shall have voting rights only with respect to NYSEG's or RG&E's, respectively, right to commence any voluntary bankruptcy without the consent of the holder of that share of stock. If either NYSEG or RG&E, respectively, has failed to propose a shareholder approved by the Commission within six months after the closing of the acquisition, the Commission will appoint a shareholder of its own selection.

(c) In the event that NYSEG or RG&E is unable to meet this condition despite good faith efforts to do so, it must petition for relief from this condition, explaining why the condition is impossible to meet and how it proposes to meet an underlying requirement that a bankruptcy involving Iberdrola, Energy East, or any other affiliate does not result in its voluntary inclusion in such a bankruptcy.

5. Financial Transparency and Reporting Conditions

(a) Energy East, NYSEG, and RG&E must continue to use U.S. Generally Accepted Accounting Principles (GAAP) for all financial reporting purposes.

(b) NYSEG and RG&E must continue to satisfy all reporting requirements that currently apply to them.

(c) After the closing of this acquisition Energy East must continue to comply with the provisions of the Sarbanes-Oxley Act (SOX) as if it were still bound directly by the provisions of the SOX. Energy East's periodic statutory financial reports must continue to include certifications provided by its officers concerning compliance with SOX requirements as if still bound directly by the provisions of SOX.

(d) Energy East, NYSEG, and RG&E shall remain subject to annual attestation audits by independent auditors.

(e) Iberdrola, Energy East, NYSEG, and RG&E must provide Staff access to the books and records, including, but not limited to, consolidated tax returns, of Iberdrola and all of its affiliates to the extent necessary for Staff to determine whether the rates and charges of NYSEG and RG&E are just and reasonable. Among other things, such access must be sufficient to provide Department of Public Service Staff the opportunity to ensure that costs are allocated equitably among affiliates and that intercompany transactions involving either NYSEG or RG&E are priced reasonably compared to transactions involving similarly situated Iberdrola affiliates. That access must include, but not be limited to, all information supporting the underlying costs and the basis for any factor that determines the allocation of those costs.

(f) (i) Iberdrola must file annually with the Commission financial statements, including balance sheets, income

statements, and cash flow statements for Iberdrola and its major regulated and unregulated energy company subsidiaries in the United States. Domestic business entities with annual revenues less than five percent of total domestic U.S. revenues may be aggregated, provided that each entity included is fully identified. Energy utility information must be fully consistent with former SEC Form U-9C-3.

(ii) Iberdrola must file annually with the Commission historical consolidating balance sheets, income statements, and cash flow statements in a format similar to former SEC Form U-5S. These statements must specifically show financial results for Energy East, RGS Energy Group, NYSEG, and RG&E and must link the specific Energy East, RGS Energy Group, NYSEG, and RG&E account balances to the overall consolidated results. Although individual statements for individual business entities other than Energy East, RGS Energy Group, NYSEG, and RG&E are not required, Iberdrola's consolidating statements must show the aggregate results for both its unregulated and its regulated subsidiaries separately.

(iii) To the extent that information required by clause (i) or clause (ii) of this subparagraph is presented in an IFRS format, Iberdrola must provide answers within 10 business days to any question raised by the Commission or Department of Public Service Staff concerning the format or the content of the financial statements.

(g) All information required by the financial transparency and reporting requirements in subparagraphs (a) through (f) above must be provided in English and stated in U.S. dollars and shall be publicly available.

6. Affiliate Transactions, Cost Allocations, and Code of Conduct

(a) Iberdrola shall be subject to the rules, practices, and procedures in the existing code of conduct governing relations among Energy East and its subsidiaries,<sup>1</sup> including, but not limited to, NYSEG and RG&E, in the same manner as they apply to Energy East.

(b) Staff, Petitioners, and other interested parties shall consult and use their best efforts to resolve their differences over all issues raised in this proceeding concerning the code of conduct and affiliate transaction and cost allocation rules to apply among Iberdrola and its subsidiaries, including, but not limited to, Energy East, NYSEG, RG&E, and Community Energy, Inc. Within 60 days from the date of this order, the parties must submit a report on the status of their negotiations, either advising us that they have reached agreement, with an accompanying joint proposal incorporating the terms of agreement for Commission approval, or that they require an additional 30 days for further negotiations. If the parties have failed to reach agreement within that 60-day period, then within 90 days from the date of this order they must submit a report on the final results of their negotiations, either advising us that they have reached agreement, with an accompanying joint proposal incorporating the terms of agreement for Commission approval, or specifying the matters on which there is agreement, the extent of any remaining differences, and the bases for remaining differences. The Commission will then consider and act upon the parties' submission, including establishing any additional

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<sup>1</sup> Set forth in Appendix B to the Joint Proposal approved in Case 01-M-0404, Energy East Corporation, et al. - Merger and Stock Acquisition, Order Adopting Provisions of Joint Proposal with Modifications (issued February 27, 2002).

process it deems necessary at that time. Pending further action by the Commission, all existing provisions of the code of conduct shall continue to apply without modification, subject to subparagraph (a) above.

7. Follow-On Merger Savings

In the event that Iberdrola completes any additional mergers or acquisitions within the United States before the Commission adopts an order approving new rates for NYSEG or RG&E, Iberdrola must share the follow-on merger savings between shareholders and ratepayers. NYSEG and RG&E must submit, within 90 days of the follow-on merger closing, a comprehensive and detailed proposal to share the follow-on merger savings, to begin on the closing date of the follow-on merger. The proposal must provide for a minimum 50 percent ratepayer share of synergy savings and efficiency gains, net of costs to achieve. In addition, the proposal must include an allocation method for sharing the synergy savings and efficiency gains among corporate entities. NYSEG and RG&E must share such savings and gains with their ratepayers until the Commission approves new rates in response to a request for a rate change. The ratepayer share shall be set aside in a deferral account for future Commission disposition.

APPENDIX 2

SAFETY, RELIABILITY, AND CUSTOMER SERVICE PROTECTION CONDITIONS

1. General Performance and Reporting Conditions

(a) Negative electric system reliability revenue adjustments for New York State Electric & Gas Corporation (NYSEG) and Rochester Gas and Electric Corporation (RG&E) shall apply beginning in calendar year 2009 in accordance with this table<sup>1</sup>:

|                          | Performance Target | Base Revenue Adjustment |
|--------------------------|--------------------|-------------------------|
| <b>Frequency (SAIFI)</b> |                    |                         |
| NYSEG                    |                    |                         |
| Minimum Threshold        | 1.20               | \$1,750,000             |
| Maximum Threshold        | 1.26               | \$3,500,000             |
| RG&E                     | 0.90               | \$2,500,000             |
| <b>Duration (CAIDI)</b>  |                    |                         |
| NYSEG                    |                    |                         |
| Minimum Threshold        | 2.08               | \$1,750,000             |
| Maximum Threshold        | 2.18               | \$3,500,000             |
| RG&E                     | 1.90               | \$2,500,000             |

(b) For each consecutive calendar year that a performance target in the table in subparagraph (a) is missed, the revenue adjustment shall be twice the adjustment applicable for the prior year.

(c) Within 90 days from the date of this order, NYSEG and RG&E each shall file with the Commission a report that includes: an assessment of the physical conditions of all elements of its electric system; and repair plans, remedial actions, and

<sup>1</sup> "SAIFI" is System Average Interruption Frequency Index.  
"CAIDI" is Customer Average Interruption Duration Index.

monitoring programs for correcting problems with facilities found deficient.

(d) Effective beginning in calendar year 2009, NYSEG shall be subject to the following gas safety performance measures and base negative adjustment levels, totaling up to 60 basis points, for failure to meet those measures:

(i) Leak prone pipe:

(a) Replace a minimum of 20 miles of leak-prone main. Base adjustment level: eight basis points.

(b) Replace a minimum of 2,000 leak-prone services. Base adjustment level: eight basis points.

(ii) Leak management: achieve a year-end backlog of total leaks no greater than 100. Base adjustment level: 12 basis points.

(iii) Prevention of excavation damages:

(a) Overall damages: maintain a level equal to or below 2.0 excavation damages per 1,000 One-Call Tickets. Base adjustment level: four basis points.

(b) Damages due to mismarks: maintain a level equal to or below 0.50 excavation damages due to mismarks per 1,000 One-Call Tickets. Base adjustment level: 10 basis points.

(c) Damages caused by company crews and company contractors: maintain a level equal to or below 0.20 excavation damages attributable to company and company contractor personnel per 1,000 One-Call Tickets. Base adjustment level: four basis points.

(iv) Emergency response:

(a) Respond to 75 percent of all gas leak and odor calls within 30 minutes. Base adjustment level: eight basis points.

(b) Respond to 90 percent of all gas leak and odor calls within 45 minutes. Base adjustment level: four basis points.

(c) Respond to 95 percent of all gas leak and odor calls within 60 minutes. Base adjustment level: two basis points.

(e) Effective beginning in calendar year 2009, RG&E shall be subject to the following gas safety performance measures and base negative adjustment levels, totaling up to 60 basis points, for failure to meet those measures:

(i) Leak prone pipe:

(a) Replace a minimum of 20 miles of leak-prone main. Base adjustment level: eight basis points.

(b) Replace a minimum of 2,000 leak-prone services. Base adjustment level: eight basis points.

(ii) Leak management: achieve a year-end backlog of total leaks no greater than 200. Base adjustment level: 12 basis points.

(iii) Prevention of excavation damages:

(a) Overall damages: maintain a level equal to or below 2.0 excavation damages per 1,000 One-Call Tickets. Base adjustment level: four basis points.

(b) Damages due to mismarks: maintain a level equal to or below 0.50 excavation damages due to mismarks per 1,000 One-Call Tickets. Base adjustment level: 10 basis points.

(c) Damages caused by company crews and company contractors: maintain a level equal to or below 0.20 excavation damages attributable to company and company contractor personnel per 1,000 One-Call Tickets. Base adjustment level: four basis points.

(iv) Emergency response:

(a) Respond to 75 percent of all gas leak and odor calls within 30 minutes. Base adjustment level: eight basis points.

(b) Respond to 90 percent of all gas leak and odor calls within 45 minutes. Base adjustment level: four basis points.

(c) Respond to 95 percent of all gas leak and odor calls within 60 minutes. Base adjustment level: two basis points.

(f) If NYSEG or RG&E, respectively, misses a target level set forth in subparagraph (d) or (e) above in three out of five consecutive calendar years, the negative adjustment applicable for that year and each subsequent year shall be twice the base adjustment level. For any calendar year in which NYSEG or RG&E, respectively, is under a dividend restriction at any time and misses a target level set forth in subparagraph(d) or (e) above, the negative adjustment applicable shall be 150 percent of the adjustment level otherwise applicable.

(g) The Gas Cost Incentive Mechanism-2 for NYSEG and RG&E is terminated effective December 31, 2008.

(h) Negative customer service revenue adjustments for NYSEG and RG&E shall apply beginning in calendar year 2009 in accordance with this table:

| Performance Target      | Base Revenue Adjustment |                    |
|-------------------------|-------------------------|--------------------|
|                         | Electric                | Gas                |
| <b>NYSEG</b>            |                         |                    |
| PSC Complaint Rate      | \$3,000,000             | \$333,333          |
| Overall Customer Satis. | \$2,000,000             | \$333,333          |
| Contact Satisfaction    | \$2,000,000             | \$333,333          |
| <b>Total</b>            | <b>\$7,000,000</b>      | <b>\$1,000,000</b> |
| <b>RG&amp;E</b>         |                         |                    |
| PSC Complaint Rate      | \$833,333               | \$233,333          |
| Cust. Service Index     | \$833,333               | \$233,333          |
| Appointments Kept       | \$833,333               | \$233,333          |
| Calls Answered          | \$833,333               | \$233,333          |
| Billing Accuracy        | \$833,333               | \$233,333          |
| Estd. Meter Reads       | \$833,333               | \$233,333          |
| <b>Total</b>            | <b>\$5,000,000</b>      | <b>\$1,400,000</b> |

(i) For each consecutive calendar year that a performance target in the table in subparagraph (h) is missed, the revenue adjustment shall be twice the adjustment applicable for the prior year.

(j) The impact of any negative adjustment under subparagraphs (a), (b), (d), (e), (f), (h), or (i) above shall be excluded from all regulatory measurements, such as, calculations to implement an excess earnings or a revenue decoupling mechanism. Negative adjustments shall not be recovered directly or indirectly from ratepayers.

(k) Within 60 days from the end of each calendar year, NYSEG and RG&E shall file their annual reports with the Commission showing how they performed for each of the applicable electric reliability, gas safety, and customer service performance measures in subparagraphs (a), (d), (e), and (h) above.

## 2. Capital Expenditure Conditions

(a) For the years 2009 and 2010, NYSEG shall make capital expenditures of no less than an average of \$140 million per year for its electric system and no less than an average of \$20 million per year for its gas system.

(b) For the years 2009 and 2010, RG&E shall make capital expenditures of no less than an average of \$90 million per year for its electric system and no less than an average of \$20 million per year for its gas system.

(c) For years after 2010, NYSEG and RG&E, respectively, shall make capital expenditures at levels no less than 90 percent of the levels set forth in subparagraphs (a) and (b) above. In the event that either company proposes to spend at a level less than 90 percent of a level set forth in subparagraph (a) or (b), it shall submit its proposal to the Commission for approval, together with a full justification of how its proposal will provide for continued safe and adequate service.

(d) NYSEG and RG&E shall each file annually, within 30 days from the close of its annual planning cycle, a five-year forecast of its planned electric system and gas system upgrades, including the expected cost of each project or program. The annual filing shall also include a reconciliation (*i.e.*, variance report) of the past year's construction activity compared to its budget for that year.

3. Conditions Specific to Concerns of NYAPP/NYSRECA

(a) NYSEG shall establish a "task force" that includes representatives from Delaware County Electric Cooperative, Oneida-Madison Electric Cooperative, Otsego Electric Cooperative Steuben Rural Electric Cooperative ("cooperatives"), the Village of Sherburne, and NYSEG personnel. The task force shall hold meetings no less than quarterly and establish milestones to achieve numerous objectives. The objectives of the task force include:

(i) Capital investments: includes identifying capital improvements that could be made to enhance system reliability with respect to the system used to serve the cooperatives and the Village of Sherburne and agreeing on an overall schedule for implementation of certain capital improvements, which would be submitted for consideration in subsequent rate proceedings.

(ii) Transmission study: NYSEG shall conduct a transmission study, to be completed no later than 90 days after the closing of the Iberdrola acquisition of Energy East, to determine the age and capacity of all facilities providing service to the substations owned and controlled by the cooperatives and the Village of Sherburne. The study shall be provided to the cooperatives and Sherburne for review and comment.

(iii) Within 30 days after completion of the transmission study, NYSEG planning and engineering personnel shall hold a meeting with representatives of the cooperatives and the Village of Sherburne, and invite Department of Public Service Staff to attend, to discuss specific implementation measures.

(iv) Review of history, repair, and maintenance activities: The task force shall review outage history and line performance, as well as specific plans and schedules associated with the maintenance of transmission and sub-transmission facilities that service the cooperatives and the Village of Sherburne.

(v) Actions taken consistent with the process described above shall be implemented utilizing best efforts on a mutually agreed upon schedule and NYSEG commits to take additional corrective actions to the extent required.

(vi) Storm response: NYSEG shall provide the cooperatives and the Village of Sherburne with data related to the response to storm conditions that affect the cooperatives' and the Village of Sherburne's customers. This data shall be compared to data on NYSEG's overall storm response.

(vii) Notifications: NYSEG shall prioritize responses for any outage affecting the cooperatives' customers and customers of the Village of Sherburne as it would for an outage affecting a similar number of its own retail customers. Proper prioritization and response shall require continued communication and coordination among the parties. Review of outages, communications, and response shall be topics for the ongoing task force. A specific communications protocol shall be jointly developed that is not merely an automated outage report line, but shall include, and not be limited to, senior NYSEG personnel and other appropriate persons. Protocols shall be jointly established no later than 90 days after the closing of the Iberdrola acquisition of Energy East.

(viii) Reliability: NYSEG acknowledges the concerns expressed by the cooperatives and the Village of Sherburne regarding present and future electric reliability, without making any admissions. For the future, the parties shall develop guidelines that are intended to lead to the development of a penalty and enforcement protocol for failure of NYSEG to satisfy such guidelines, including, but not limited to: (a) minimum employment levels for NYSEG personnel dedicated to reliability requirements and operation and maintenance on transmission and sub-transmission facilities; and (b) maximum response times for outages.

(b) Reservation of rights: the conditions set forth in subparagraph (a) are subject to the reserved rights of the cooperatives and the Village of Sherburne to challenge NYSEG's implementation of its obligations in any and all forums.

#### 4. Conditions Specific to Concerns of the City of Rochester

(a) Petitioners shall promptly begin comprehensive collaborative discussions with the City of Rochester, Department of Public Service Staff, and representatives of the Department of Environmental Conservation (DEC) to review the plans and schedules for the remediation of the Beebee Station and Andrews Street sites of RG&E, with the understanding that both of these sites are already in the DEC remediation "queue." RG&E shall share schedules and milestone data, along with periodic progress reports, with the City of Rochester.

(b) If the City of Rochester continues its interest in public access to RG&E's 81 South Avenue facility, RG&E shall work with the City on a schedule to review the facility's structural condition expeditiously and to make any necessary safety enhancements required for public access.

## APPENDIX 3

### VERTICAL MARKET POWER CONDITIONS

#### Divestiture of Fossil Generation; Corporate Separation of Non-hydro Generation Affiliates

1. Petitioners shall file with the Secretary to the Commission, within 90 days of the closing of this acquisition, a plan for divestiture of any fossil generation owned by any Iberdrola affiliate in New York State.
2. Iberdrola and Energy East and any of their affiliates are prohibited from owning any interest in fossil generation within New York State.
3. Any investments in wind facilities shall be carried out through Iberdrola subsidiaries other than NYSEG or RG&E.
4. NYSEG and RG&E shall not engage or enter into bilateral power purchase contracts with any affiliate or subsidiary.

#### Generator Interconnection Process

5. NYSEG and RG&E shall file with the Secretary to the Commission, within 60 days from the date of issuance of this Order, documents clearly defining interconnection criteria and the process and procedures that would provide assurance of transparency of decisions to provide interconnections to generators, and shall file promptly any subsequent changes to the documents.

6. NYSEG and RG&E shall report to the Secretary to the Commission on the first of each month, beginning October 1, 2008, any request for interconnection from any generator in the previous month, including affiliated and non-affiliated generators.

7. NYSEG and RG&E shall document, maintain, and make available to the Department of Public Service Staff, upon request, any communication with developers of generation in a timely fashion.

8. NYSEG and RG&E shall respond within five business days to any request relating to interconnection from a generator or other entity directly involved in the interconnection process, such as the New York Independent System Operator (NYISO), or provide an estimated date for delivery of the response with an explanation for the delay.

#### Generator Energy Deliverability

9. Generator-Specific Economic Deliverability Studies:

(a) Within 60 days from the date of the issuance of this Order, NYSEG and RG&E shall file with the Secretary to the Commission documents that clearly define their methods for performing economic deliverability studies for interconnecting generators, including affiliated and non-affiliated generators. The documents shall include, at a minimum, procedures for generic study methodologies, a process for working with generators in performance of the studies, remedies for potential congestion situations, a generic methodology for evaluating solutions and generic

cost allocation procedures for the solutions, and a process for working with each generator regarding solutions.

(b) NYSEG or RG&E, as applicable, shall perform economic deliverability studies for each generator applying for interconnection to its system to determine if the generator is subject to potential restrictions in energy delivery and provide to the generator a detailed explanation of the economic deliverability study test.

(c) NYSEG or RG&E, as applicable, shall provide to the generator a statement of the costs of system upgrades required to remove or substantially reduce expected economic delivery restrictions and the share of the costs for which the generator is responsible, per the cost allocation procedures submitted to the Secretary to the Commission.

(d) NYSEG and RG&E shall file any such economic deliverability studies with the Secretary to the Commission within 15 days of the study's completion.

10. Bottled Generation Study: NYSEG and RG&E shall periodically conduct a study to identify potential congestion pockets in their service territories where generation could be bottled. The study shall identify the transmission measures required to alleviate the congestion and assess the cost effectiveness of implementing such measures. The study shall also determine the existing generation resources that will potentially be forced to curtail energy output and estimate the amount due to the new wind facilities. The study shall be conducted by an independent third party using shareholder funding. NYSEG and RG&E shall work with Department of Public Service Staff in developing the precise scope of the study. In

the event that NYSEG and RG&E and Department of Public Service Staff cannot resolve a dispute, the Staff shall request the Public Service Commission to provide a resolution of the dispute. NYSEG and RG&E shall provide a detailed and comprehensive scope of the study and associated timeline with milestones to the Secretary to the Commission within 30 days of the date of the issuance of this Order. The study shall, at a minimum, include planning for the next ten years, and model any wind projects in the New York Independent System Operator interconnection queue and projects of which NYSEG and RG&E are aware with an in-service date through the end of 2013. The scope of the study shall include base case assumptions and describe sensitivity and scenario cases included in the study. NYSEG and RG&E shall file the final results of the first study with the Secretary to the Commission no later than June 30, 2009. The study shall be repeated once every three years.

#### Other Conditions Relating to Generators

11. New York State Electric and Gas Corporation (NYSEG) and Rochester Gas and Electric Corporation (RG&E) shall notify the Secretary to the Commission of any disagreement with a developer of generation relating to the performance of interconnection or energy deliverability studies that they cannot resolve in good faith.

12. NYSEG and RG&E shall attempt to resolve in good faith any contested issues with generators. NYSEG, RG&E, or a generator may file a request with the Department of Public Service for mediation or arbitration of the dispute.

Monitoring Extent of Generation Holdings

13. Iberdrola and any of its subsidiaries that begin construction or acquire any direct or indirect interest in co-generation, hydro, or alternate energy production facilities, including wind generation, with a capacity of 80 megawatts or less are required to notify the Secretary to the Commission, within 60 days of such construction, investment, or acquisition.

STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION

CASE 07-M-0906 - Joint Petition of Iberdrola, S.A., Energy East Corporation, RGS Energy Group, Inc., Green Acquisition Capital, Inc., New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation for Approval of the Acquisition of Energy East Corporation by Iberdrola, S.A.

MAUREEN F. HARRIS, concurring

I concur with the decision, but have specific concerns and issues, raised on the transcripts of the sessions, that I wish to address. I will offer a full concurring statement when the longer version of the Commission's order is issued in this case.